

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE)	
COMMISSION OF THE ENVIRONMENTAL)	
SURCHARGE MECHANISM OF KENTUCKY)	CASE NO. 98-106
POWER COMPANY d/b/a AMERICAN ELECTRIC)	
POWER AS BILLED FROM JULY 1, 1997 TO)	
DECEMBER 31, 1997)	

O R D E R

On February 27, 1998, the Commission initiated its first six-month review of Kentucky Power Company's ("Kentucky Power"), d/b/a American Electric Power, environmental surcharge as billed to customers from July 1, 1997 through December 31, 1997.¹ Pursuant to KRS 278.183(3) the Commission must review, at six-month intervals, the past operations of the surcharge and, after hearing, disallow any surcharge amounts that are not just and reasonable and reconcile past surcharge collections with actual costs recoverable.

In anticipation that all parties in Case No. 96-489² would desire to participate in this proceeding, the Attorney General's Office and the Kentucky Industrial Utility Customers were deemed parties to this proceeding. An informal conference to discuss

¹ Since Kentucky Power's surcharge is billed on a two-month lag, the amounts billed from July 1997 through December 1997 are based on costs incurred from May 1997 through October 1997.

² Case No. 96-489, The Application of Kentucky Power Company d/b/a American Electric Power to Assess a Surcharge Under KRS 278.183 to Recover Costs of Compliance with the Clean Air Act and Those Environmental Requirements Which Apply to Coal Combustion Waste and By-Products, final Order dated May 27, 1997.

technical issues was held on May 19, 1998. A public hearing was held on June 10-11, 1998.

ENVIRONMENTAL RATE BASE BALANCES

The current period revenue requirement in Kentucky Power's³ environmental surcharge includes the calculation of a return on environmental rate base for Kentucky Power's Big Sandy generating station ("Big Sandy") and a portion of Indiana Michigan's Rockport generating station ("Rockport").⁴ When reviewing the October expense month calculations, the Commission noted that the balances reported for Accumulated Depreciation and Accumulated Deferred Income Taxes in October matched those reported for the September expense month. Upon inquiry, Kentucky Power stated that it had intended to use the beginning of the month balances for these accounts in the calculation of the current period revenue requirement, contending that this was consistent with what it had filed, and the Commission accepted, in Case No. 96-489. Kentucky Power had inadvertently used the end of the month balances in the first five monthly filings, and it corrected this error with the October expense month filing.⁵ Kentucky Power believed that it was appropriate to use the beginning balances for the

³ Kentucky Power is a wholly owned subsidiary of American Electric Power, Inc. ("AEP"), and is part of the AEP System, a multistate public utility holding company. The other operating companies in the AEP System are Ohio Power Company ("Ohio Power"), Indiana Michigan Power Company ("Indiana Michigan"), Appalachian Power Company, and Columbus Southern Power Company.

⁴ The rate base for Big Sandy is the Net Utility Plant (Utility Plant at Original Cost less Accumulated Depreciation and Accumulated Deferred Income Taxes) plus the Emission Allowance Inventory. The rate base for Rockport only includes the Net Utility Plant.

⁵ Response to the Commission's February 27, 1998 Order, Item 2(a-c).

two accounts, since the Commission did not instruct Kentucky Power to do otherwise, with the exception that the Emission Allowance Inventory balance was specifically required to reflect the end of the month balance.⁶

The Commission was unaware of Kentucky Power's assumptions concerning the use of beginning of month balances for Accumulated Depreciation and Accumulated Deferred Income Taxes. When calculating the various elements of rate base, the Commission traditionally uses end of the test year or 13-month average balances. This approach is currently used in all of the surcharge mechanisms for other utilities in Kentucky. Given Kentucky Power's position on the use of beginning balances, and the Commission's expressed requirement that the Emission Allowance Inventory balance be as of the end of the month, Kentucky Power would be faced with calculating an environmental rate base that contained the account balances of differing time periods.

The May 19, 1998 informal conference addressed this issue. Kentucky Power stated that its only desire was to establish consistency within the surcharge mechanism.⁷ Kentucky Power indicated that it had no objection to using the end of month balances.⁸ Kentucky Power filed its May 1998 expense month calculations using the end of month balances. The Commission finds that the end of month balances should be utilized in the environmental rate base calculations.

⁶ Response to the Commission's April 3, 1998 Order, Item 2(b).

⁷ Informal Conference Memorandum, filed May 22, 1998. The Commission Staff agreed with Kentucky Power that there was a need for the mechanism to be consistent.

⁸ Id.; also see Transcript of Evidence ("T.E."), Volume I, June 10, 1998, at 26.

RATE OF RETURN

In Case No. 96-489, Kentucky Power proposed that the debt portion of its weighted average cost of capital be recalculated monthly to more closely reflect the cost actually incurred. The rate of return on common equity would remain fixed and subject to review during the 2-year environmental surcharge reviews. The Commission accepted Kentucky Power's proposal concerning the rate of return on common equity, but found that the debt portion of the weighted average cost of capital should remain fixed during the 6-month period, and be reviewed and re-established during each 6-month review case.⁹ This proceeding represents the first opportunity to review the debt portion of the weighted average cost of capital.

Kentucky Power provided the outstanding balances for its long-term debt, short-term debt and common equity as of December 31, 1997, the last billing month of the review period. It also provided the blended interest rates of the long-term and short-term debt. Based on this information,¹⁰ Kentucky Power's weighted average cost of capital, before income tax gross-up, is as follows:

	<u>Capital Structure</u>	<u>Cost</u>	<u>Weighted Cost</u>
Long-Term Debt	53.72%	7.728%	4.151%
Short-Term Debt	5.75%	6.805%	.391%
Common Equity	40.53%	11.500%	<u>4.661%</u>
Weighted Average Cost of Capital			9.203%

⁹ Case No. 96-489, final Order dated May 27, 1997, at 32 and 35. The Commission's August 18, 1997 Order on Rehearing, at 2, established the weighted average cost of capital was 9.215 percent.

¹⁰ Response to the Commission's February 27, 1998 Order, Item 4.

The Commission has reviewed Kentucky Power's calculations and finds them to be reasonable and consistent with the Commission's decisions in Case No. 96-489. Therefore, Kentucky Power should use a weighted average cost of capital of 9.203 percent in all monthly environmental surcharge filings subsequent to the date of this Order.

SURCHARGE ADJUSTMENT

For the 6-month period, Kentucky Power initially determined it had over-recovered its environmental costs by \$25.¹¹ The over-recovery was related to three specific adjustments: a correction to Kentucky Power's emission allowance inventory, an adjustment to Kentucky Power's share of Ohio Power's Gavin generating station scrubber expenses, and the environmental rate base reporting period issue. When the revision to the environmental rate base calculations, discussed previously in this Order, were considered, Kentucky Power indicated that it had over-recovered its environmental costs by \$280.¹² In addition, Kentucky Power provided calculations at the public hearing which showed the adjustment for the environmental rate base issue for the months subsequent to the review period.¹³ Kentucky Power indicated that it had no problem recognizing and increasing its over-recovery by an additional \$198 in this case.¹⁴ Kentucky Power has indicated that it is agreeable to returning the over-recovery

¹¹ Id., Item 1, sheet 2 of 2.

¹² T.E., Volume I, June 10, 1998, at 24-25.

¹³ AEP Hearing Exhibit No. 2.

¹⁴ T.E., Volume I, June 10, 1998, at 26-27. AEP Hearing Exhibit No. 2 indicated a total over-recovery of \$234. However, \$36 of that over-recovery is already included in the \$280 calculation.

to its customers through an adjustment to its ES Form 3.3 in some future monthly filing.¹⁵

The Commission has reviewed and finds reasonable Kentucky Power's calculation of its revised over-recovery of \$280 for this 6-month review period. In addition, the Commission finds it reasonable to recognize the over-recovery of \$198 related to the environmental rate base calculation issue. The inclusion of this further adjustment will eliminate this issue from the next 6-month review proceeding. Kentucky Power's environmental surcharge mechanism, on ES Form 3.3, provides a means to recognize over- and under-recoveries. The Commission finds it reasonable that Kentucky Power include a reduction of \$478 in its calculation of the over/under recovery adjustment on ES Form 3.3, in the first full billing month following the date of this Order.

IT IS THEREFORE ORDERED that:

1. Kentucky Power shall deduct \$478 from the environmental surcharge gross revenue requirement, through its over/under recovery adjustment calculation, in its next monthly surcharge report.

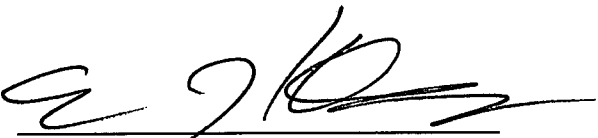
2. Kentucky Power shall use a weighted average cost of capital of 9.203 percent in all monthly environmental surcharge filings subsequent to the date of this Order.

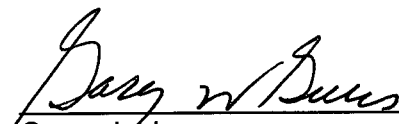
¹⁵ Response to the Commission's April 3, 1998 Order, Item 1 and T.E., Volume I, June 10, 1998, at 25. ES Form 3.3 includes an over/(under) recovery adjustment section that is normally used to recognize timing differences.

Done at Frankfort, Kentucky, this 4th day of August, 1998.

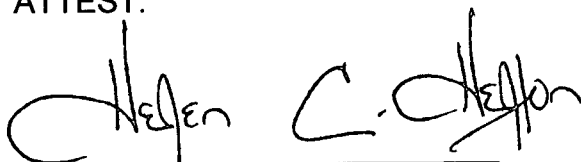
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Executive Director